

## **MANAGEMENT’S DISCUSSION AND ANALYSIS FOR THE THREE MONTHS ENDED MARCH 31, 2018**

HLS Therapeutics Inc. (“**HLS**” or the “**Company**”) was formed on March 12, 2018 by the amalgamation of HLS Therapeutics Inc. (“**former HLS**”) and Automodular Corporation (“**AMD**”). The following management’s discussion and analysis (“**MD&A**”) should be read in conjunction with the unaudited condensed interim consolidated financial statements of HLS for the three months ended March 31, 2018. References to “**HLS**” and the “**Company**” in this MD&A also refer to former HLS, as the context requires.

This discussion is presented as of May 15, 2018 and is current to that date unless otherwise stated.

The financial information presented in this MD&A is derived from the above noted financial statements prepared in accordance with International Financial Reporting Standards (“**IFRS**”), with the exception of the Selected Quarterly Information. All amounts are in thousands of United States dollars unless otherwise stated.

### **CAUTIONARY NOTE REGARDING FORWARD-LOOKING INFORMATION**

This MD&A contains forward-looking statements within the meaning of applicable securities laws. The use of any of the words “expect”, “anticipate”, “continue”, “estimate”, “objective”, “ongoing”, “may”, “will”, “project”, “should”, “believe”, “plans”, “intends”, “potential” and similar expressions are intended to identify forward-looking statements or information. More particularly and without limitation, this MD&A contains forward-looking statements and information concerning: statements with respect to HLS’s pursuit of additional product and pipeline opportunities in certain therapeutic markets; withdrawal of the competing Absorica product in the United States market; and HLS’s anticipated cash needs and its need for additional financing.

The forward-looking statements and information included in this MD&A are based on certain key expectations and assumptions made by HLS and although HLS believes that the expectations and assumptions on which such forward-looking statements and information are based are reasonable, undue reliance should not be placed on the forward-looking statements and information because HLS can give no assurance that they will prove to be correct. Since forward-looking statements and information address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. Factors and risks which could cause actual results or events to differ materially from those expressed in its forward-looking statements are discussed in HLS’s materials filed with the Canadian securities regulatory authorities from time to time, including, without limitation, the section entitled “Part IV – Information Concerning HLS – Risk Factors” in the Circular.

The forward-looking statements and information contained in this MD&A are made as of the date hereof and HLS undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.

## CAUTIONARY NOTE REGARDING NON-IFRS MEASURES

This MD&A refers to certain non-IFRS measures. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of HLS's results of operations from management's perspective. Accordingly, they should not be considered in isolation nor as a substitute for analysis of HLS's financial information reported under IFRS. HLS uses non-IFRS measures to provide investors with supplemental measures of its operating performance and thus highlight trends in its core business that may not otherwise be apparent when relying solely on IFRS financial measures. HLS also believes that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers. HLS's management also uses non-IFRS measures in order to facilitate operating performance comparisons from period to period, prepare annual operating budgets and assess HLS's ability to meet its future debt service, capital expenditure and working capital requirements.

In particular, management uses Adjusted EBITDA as a measure of HLS's performance. To reconcile net loss for the year with Adjusted EBITDA, each of (i) "stock-based compensation", (ii) "amortization and depreciation", (iii) "acquisition and transaction costs", (iv) "finance and related costs", and (v) "provision for (recovery of) income taxes" appearing in the Selected Consolidated Financial Information presented below are added to net loss for the period to determine Adjusted EBITDA. Adjusted EBITDA does not have any standardized meaning prescribed by IFRS and is not necessarily comparable to similar measures presented by other companies. Adjusted EBITDA should not be considered in isolation or as a substitute for net income (loss) prepared in accordance with IFRS as issued by the IASB.

	Three months ended	
	March 31, 2018	March 31, 2017
Net loss for the period	(4,876)	(3,032)
Stock-based compensation	94	76
Amortization and depreciation	8,141	7,931
Acquisition and transaction costs	435	—
Finance and related costs	5,567	5,705
Provision for (recovery of) income taxes	(769)	868
Adjusted EBITDA	8,592	11,548

## OVERVIEW

HLS is an international specialty pharmaceutical company focused on acquiring (either through acquisitions, in-licensing or similar arrangements) and commercializing clinically differentiated pharmaceutical products in the specialty central nervous system and cardiovascular markets. As at March 31, 2018, HLS's lead product is Clozaril® (an atypical antipsychotic indicated in the management of symptoms of treatment-resistant schizophrenia) for the Canadian and United States markets. HLS also holds the United States marketing rights to Absorica® (a commercial stage dermatology product) which, in effect, provides HLS with income based on United States sales of Absorica by a third party.

In 2017, the Company entered into a license agreement to register, commercialize and distribute Vascepa® capsules in Canada. Vascepa capsules are intended to be registered as a single-molecule prescription product for the treatment of high triglycerides and potentially other cardiovascular

indications. Also in 2017, the Company entered into a license agreement to commercialize and distribute in Canada a second product related to the treatment of cardiovascular disease contingent on achieving certain regulatory milestones.

HLS intends to pursue additional product and pipeline opportunities in the central nervous system and cardiovascular therapeutic markets, and potentially in other therapeutic areas, through targeted business development efforts.

## **AMALGAMATION**

On March 12, 2018, the Company completed a plan of arrangement AMD in accordance with Section 183 of the *Business Corporations Act* (Ontario). Pursuant to the Arrangement, the Company and AMD amalgamated to form a new entity named HLS Therapeutics Inc., operating in the life sciences industry. The completion of the Arrangement resulted in a reverse takeover of AMD as defined in the policies of the TSX Venture Exchange (the "Exchange"). New HLS common shares commenced trading on the Exchange on March 14, 2018.

Under the Arrangement, AMD shareholders received, for each AMD share, one preferred share of new HLS and 0.165834 common share of new HLS, and HLS shareholders received, for each HLS share, one new HLS common share. At the completion of the Arrangement, former shareholders of HLS held approximately 92% of the outstanding common shares of new HLS. As a result, HLS is considered the acquiring company for accounting purposes.

HLS preferred shares were issued to former AMD shareholders to allow them to receive their pro rata share of proceeds from the settlement of AMD's pre-existing litigation and any residual funds that were in excess of AMD's commitment to deliver C\$25.0 million to HLS on closing of the Arrangement. Prior to closing the Arrangement, AMD announced that it had reached a settlement related to the litigation. The settlement proceeds were then received by AMD on March 8, 2018 and such funds, along with the residual funds, are being held in escrow as at March 31, 2018.

## **KEY PERFORMANCE INDICATORS**

HLS measures the success of its strategies using several key performance indicators. These include Revenues, and Adjusted EBITDA, as described above. HLS believes these are important measures as they allow the company to evaluate its operating performance and identify financial and business trends relating to its financial condition and results of operations.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

	Three months ended	
	March 31, 2018	March 31, 2017
<b>Revenues</b>	13,166	15,553
Cost of product sales	580	425
Selling and marketing	964	786
Medical, regulatory and patient support	977	906
General and administrative	2,053	1,888
Adjusted EBITDA	8,592	11,548
Stock-based compensation	94	76
Amortization and depreciation	8,141	7,931
Operating income	357	3,541
Acquisition and transaction costs	435	—
Finance and related costs	5,567	5,705
Loss before income taxes	(5,645)	(2,164)
Provision for (recovery of) income taxes	(769)	868
<b>Net loss for the period</b>	<b>(4,876)</b>	<b>(3,032)</b>
<b>Net loss per share:</b>		
Basic and diluted	<b>\$(0.19)</b>	<b>\$(0.12)</b>

	As at	As at
	March 31, 2018	December 31, 2017
Cash and cash equivalents	53,825	36,219
Total assets	385,347	384,646
Total long-term financial liabilities	156,768	158,114
Total shareholders' equity	189,719	180,382

## RESULTS OF OPERATIONS

The following section provides management's analysis of operating results, including key performance indicators.

### Revenue

	Three months ended	
	March 31, 2018	March 31, 2017
<b>Product sales</b>		
Canada	6,759	6,335
United States	4,872	4,289
	11,631	10,624
<b>Royalty revenue</b>	1,535	4,929
	13,166	15,553

In the Canadian market, where Clozaril is actively promoted and supported by a team of HLS employees, first quarter product sales in fiscal 2018 increased by 7% in United States dollars compared to the prior year. In Canadian dollars, the increase in the first quarter of fiscal 2018 was 2%.

Product sales in the U.S. market also increased in fiscal 2018, due primarily to a slow start to sales in fiscal 2017 as well as additional product sales in fiscal 2018 under an authorized generic supply agreement. Otherwise, Clozaril in the U.S. market continues to experience modest volume declines, mitigated by a nominal price increase.

Royalty revenues in fiscal 2017 benefited by approximately \$10.0 to \$11.0 million due to competitive disruptions and the positive impact of a promotional campaign undertaken by the distributor of Absorica in the U.S., which ran from early 2017 through November 2017. Absorica activity in fiscal 2018 is expected to return to levels that are more consistent with the results generated prior to the start of the 2017 promotional campaign and that are more in line with projections the Company had in place when acquiring the marketing rights in 2016. Due to higher sales levels in 2017, trade inventory levels had expanded by the end of the promotional period, resulting in a period of trade inventory destocking in the first quarter of 2018. This destocking resulted in lower revenues to the distributor and thus lower royalties to the Company in the first quarter of fiscal 2018. Within the first quarter of fiscal 2018 itself, results for the month of March had already begun to show a return to levels that would be consistent with the period before the start of 2017 promotional campaign.

#### Operating expenses

	Three months ended	
	March 31, 2018	March 31, 2017
Cost of product sales	580	425
Selling and marketing	964	786
Medical, regulatory and patient support	977	906
General and administrative	2,053	1,888
	4,574	4,005

Cost of product sales increased in 2018 due to the additional product supplies made under an authorized generic supply agreement.

Modest increases in operating expenses reflect continued development of the HLS team and additional support for the growth of current and future portfolio products.

#### Adjusted EBITDA

	Three months ended	
	March 31, 2018	March 31, 2017
Adjusted EBITDA	8,592	11,548

Product sales growth exceeded the growth in operating expenses by \$0.4 million in the first quarter of fiscal 2018 over the same period last year. The impact, however, of the Absorica trade inventory adjustment following the increase in demand in 2017 resulted in \$3.4 million decrease in royalty revenues for the quarter, which resulted in a \$3.0 million decrease in Adjusted EBITDA for the first quarter of fiscal 2018 compared to the same period last year.

#### Non-cash operating expenses

Amortization and depreciation relate to the intangibles acquired in the Clozaril and Absorica acquisitions.

## **Finance and related costs, net**

Finance and related costs consist primarily of interest on the senior secured term loan provided under the HLS Credit Agreement, accreted interest related to debt issuance costs and long-term purchase consideration, and fair value adjustments related to financial instruments. Interest on the senior secured term loan decreased from \$4.2 million in 2017 to \$4.1 million in 2018 due to the repayment of debt over that period, offset by a higher interest rate in 2018. The Company has recorded income related to fair value changes of \$0.5 million in the current year due primarily to the impact of a weaker Canadian dollar on the Company's foreign currency forward contract.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Capital structure**

The Company financed its acquisitions through a portion of the net proceeds of each of (i) a subscription receipt financing of \$170.0 million, (ii) a common share financing of \$30.0 million, and (iii) a senior secured term facility of \$185.0 million. As at March 31, 2018, the principal debt balance outstanding under the senior secured term facility was \$144.2 million.

In addition, under the terms of the senior secured term facility, the Company may request incremental loans, for a maximum additional loan amount of \$150.0 million.

Under the terms of the senior secured term loan, the Company is required to comply with financial covenants related to the maintenance of minimum revenue, liquidity and leverage ratios, and to place a maximum on capital expenditures. Non-compliance with such covenants may trigger early repayment of the senior secured term loan. Throughout the period ended March 31, 2018, the Company was in compliance with all of the financial covenants.

The Company's stated strategy is to acquire rights to late stage, post-clinical and commercial stage branded pharmaceutical products for the North American market. This includes acquisition or in-licensing of soon-to-be fileable or promotional stage branded pharmaceutical products in selected therapeutic areas and the acquisition of select established pharmaceutical products that meet certain financial criteria. This may occur through direct rights acquisitions or through the acquisition of specialty pharmaceutical companies. To execute this strategy, the Company may need to access the additional capacity under its senior secured term loan facility or seek other sources of financing.

In connection with the amalgamation noted above, the Company issued 2,151,900 common shares in March 2018 for net proceeds of \$18.7 million.

### **Cash flow**

Cash flow from operating activities was \$13.5 million for the first quarter of fiscal 2018 compared with \$3.3 million in the first quarter of fiscal 2017. The increase is due to the collection of the fourth quarter Absorica royalty as well as stable cash generation from the Clozaril business.

Investing activities for the current year relate to ongoing quarterly payments associated with the acquisition of the Absorica marketing rights in July 2016 as well as the second up-front payment associated with the acquisition of the Vascepa distribution rights. The prior year includes quarterly payment associated with the Absorica acquisition.

Financing activities in the first quarter of fiscal 2018 include the issuance of common shares as a result of the amalgamation noted above. Fiscal 2018 also includes a quarterly payment on the debt facility, as well

as the setting aside of restricted cash balances associated with the acquisition of the Absorica marketing rights in July 2016.

### **Financial position**

As at March 31, 2018, the Company has cash and cash equivalents of \$53.8 million and a working capital balance of \$39.9 million. The Company believes that its cash balances and cash flow from operations will be sufficient to fund its operating activities for the ensuing twelve-month period.

Accounts receivable decreased from year end due to the collection of the fourth quarter Absorica royalty. Restricted assets increased due to the escrow funds acquired in the amalgamation noted above. Other financial liabilities decreased due to the payment of purchase consideration and a quarterly debt repayment, offset by preferred shares issued in the amalgamation noted above.

### **RELATED PARTY TRANSACTIONS**

The following table sets out the compensation of the Company's key management personnel, defined as the founders of the Company:

	<b>Three months ended</b>	
	<b>March 31, 2018</b>	<b>March 31, 2017</b>
Short-term employee benefits	558	607

### **COMMITMENTS**

There have been no material changes in the commitments undertaken by the Company since the year ended December 31, 2017.

### **OFF-BALANCE SHEET ARRANGEMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS**

There has been no material change in the Company's management of its exposures to credit risk, liquidity risk and market risk since the year ended December 31, 2017.

The Company has not entered into any off-balance sheet arrangements.

## SELECTED QUARTERLY INFORMATION (UNAUDITED)

	Q2	2017 Q3	Q4	2018 Q1
Product sales				
Canada	7,428	7,274	7,600	6,759
United States	4,600	5,835	4,077	4,872
	12,028	13,109	11,677	11,631
Royalty revenue	6,833	7,184	8,698	1,535
Revenues	18,861	20,293	20,375	13,166
Adjusted EBITDA	14,601	14,271	15,461	8,592
Net loss	(734)	(1,910)	(421)	(4,876)

  

	Q2	2016 Q3	Q4	2017 Q1
Product sales				
Canada	6,681	7,020	7,361	6,335
United States	4,919	4,388	4,899	4,289
	11,600	11,408	12,260	10,624
Royalty revenue	—	4,200	3,536	4,929
Revenues	11,600	15,608	15,796	15,553
Adjusted EBITDA	8,081	11,666	11,433	11,548
Net loss	(2,050)	(3,394)	(4,974)	(3,032)

## SUBSEQUENT EVENTS

### Preferred share redemption

On April 26, 2018, the Company announced that it intends to redeem 9,321,492 (71.83%) of the Company's outstanding preferred shares on May 9, 2018 on a pro rata basis. The preferred shares will be redeemed at a price of C\$0.61149 per preferred share, for a total redemption payment of C\$5.7 million. The redemption payment will be made from the available escrow funds.

### Normal course issuer bid

On May 9, 2018, the Company announced that the Exchange had approved the Company's Notice of Intention to Make a Normal Course Issuer Bid under which the Company may, if considered advisable, purchase for cancellation, from time to time over the next 12 months, up to an aggregate of 1,371,495 of its issued and outstanding common shares, being 5% of the issued and outstanding common shares as of May 7, 2018.

## OUTSTANDING SHARE DATA

As at the date of this discussion, the Company had: 27,429,897 common shares outstanding; 3,654,735 preferred shares outstanding; 1,390,470 stock options outstanding (resulting in a maximum issuance of 1,390,470 common shares); 2,527,852 warrants outstanding (resulting in a maximum issuance of 2,527,852 common shares); and 1,040,000 performance share units outstanding (resulting in a maximum issuance of 1,040,000 common shares).



## **RISK FACTORS**

For a discussion of the risks and uncertainties facing the Company, please see “*Part IV – Information Concerning HLS – Risk Factors*” commencing on page 141 of the Circular. There have been no material changes in the risks or uncertainties facing the Company since the date of the Circular.

## **SIGNIFICANT ACCOUNTING POLICIES**

A description of the Company’s significant accounting policies is included in note 2 of the Company’s audited consolidated financial statements for the year ended December 31, 2017 and are unchanged as of the date of this MD&A, with the following exceptions:

### **IFRS 9, *Financial Instruments* (“IFRS 9”)**

The Company has adopted IFRS 9 on a modified retroactive basis in accordance with the transitional provisions of IFRS 9. Results for reporting periods beginning after January 1, 2018 are presented under IFRS 9, while prior reporting period amounts have not been restated.

IFRS 9 introduces new requirements for classifying and measuring financial instruments, the recognition of expected credit losses, and hedge accounting. The adoption of IFRS 9 had no impact on the Company’s financial position or results of operations, and the Company’s financial assets and financial liabilities continue to be measured on the same basis as was previously applied under IAS 39, *Financial Instruments: Recognition and Measurement*.

The classification of financial assets and liabilities (collectively, financial instruments) is typically determined at the time of initial recognition, within the following categories:

- Amortized cost
- Fair value through income or loss
- Fair value through other comprehensive income

#### *Financial instruments carried at fair value through income or loss*

Financial instruments in this category include comprise lender warrants, preferred shares and foreign currency forward contracts.

#### *Financial instruments carried at amortized cost*

Financial instruments in this category include cash and cash equivalents, restricted cash, trade and other accounts receivable, accounts payable, purchase consideration, the senior secured term loan and the lender royalty.

Financial instruments in this category are recorded initially at fair value, and adjusted for directly attributable transaction costs and when material, a discount to reduce the payables to fair value. Financial instruments in this category are subsequently measure at amortized cost using the effective interest rate method. The effective interest rate accretion is included in *Finance and related costs, net* in the consolidated statement of loss.

### **IFRS 15, *Revenue from Contracts with Customers* (“IFRS 15”)**

The Company has adopted IFRS 15 effective January 1, 2018 on a modified retrospective basis in accordance with the transitional provisions of IFRS 15. Results for reporting periods beginning after January 1, 2018 are presented under IFRS 15, while prior reporting period amounts have not been restated and continue to be reported under IAS 18, *Revenue*.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and outlines two approaches to recognizing revenue: at a point in time or over time. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The Company has adopted the new standard using the modified retrospective application method with no restatement of comparative information. The adoption did not have an impact on the Company's financial position or results of operations.

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when the payment is received. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duties.

In the case of product sales, the determination of the fair value of consideration received or receivable includes a deduction for discounts, allowances given, provisions for chargebacks, other price adjustments and accruals for estimated future rebates and returns. The methodology and assumptions used to estimate rebates and returns include consideration of factors such as contractual terms and historical trends.

#### **FUTURE ACCOUNTING CHANGES**

The standards and interpretations that are issued but not yet effective up to the date of issuance of the Company's Annual Financial Statements are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

##### **IFRS 16, *Leases* ("IFRS 16")**

IFRS 16 was issued in January 2016 and eliminates the distinction between operating and financing leases for lessees. IFRS 16 applies a single model for all leases, with certain exemptions, that requires recognition of lease-related assets and liabilities and the related interest and depreciation expense in the financial statements. Lessor accounting is substantially unchanged. IFRS 16 will be effective from January 1, 2019 with limited early application permitted. The Company is currently assessing the impact of IFRS 16 and plans to adopt the new standard on the required effective date.